

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY  
A COMPONENT UNIT OF THE STATE OF MICHIGAN**

**REPORT ON FINANCIAL STATEMENTS  
(with required supplementary information)**

**YEAR ENDED SEPTEMBER 30, 2006**

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## INDEPENDENT AUDITORS' REPORT

Michigan Higher Education Facilities Authority  
Lansing, Michigan

October 17, 2006

We have audited the accompanying basic financial statements of the Michigan Higher Education Facilities Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Michigan Higher Education Facilities Authority as of September 30, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 17, 2006 on our consideration of the Michigan Higher Education Facilities Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages v and vi is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Maner, Costinison & Ellis, P.C.*

Certified Public Accountants



JENNIFER M. GRANHOLM  
GOVERNOR

STATE OF MICHIGAN  
DEPARTMENT OF TREASURY  
LANSING

ROBERT J KLEINE  
STATE TREASURER

**Management's Discussion and Analysis**

We are pleased to present the financial statements of the Michigan Higher Education Facilities Authority. The Michigan Higher Education Facilities Authority (the "Authority") was organized under Act 295 of the Michigan Public Acts of 1969. The mission of the Authority is to lower the cost of higher education by providing Michigan's private non-profit educational institutions access to tax-exempt capital. It is the vision of the Authority to be the first choice of capital financing for private non-profit higher educational institutions by being the most efficient and economical source of capital.

The Authority is a public corporate body within the Michigan Department of Treasury, Bureau of Bond Finance. The Authority is governed by a nine-member board appointed by the Governor with the advice and consent of the Senate. The Authority is a component unit of the State of Michigan.

The Authority issues or sells tax-exempt bonds in the regional or national public finance markets. The proceeds from these bonds are then lent to private non-profit educational institutions to finance capital projects.

The following is a condensed summary of financial information for the years ended September 30, 2006 and 2005, respectively.

**Condensed Financial Information**

Category	2006	2005
Total Assets	\$ 502,173	\$ 470,641
Total Liabilities	\$ 28,814	\$ 3,052
Total Net Assets	\$ 473,359	\$ 467,589
Operating Revenues	\$ 139,331	\$ 129,269
Operating Expenses	\$ 149,466	\$ 122,609
Operating Income (Loss)	\$ (10,135)	\$ 6,660
Nonoperating Revenue	\$ 15,905	\$ 11,518
Change in Net Assets	\$ 5,770	\$ 18,178
Ending Net Assets	\$ 473,359	\$ 467,589

Fees charged to its clients fund the operations of the Authority. The fees are based on the outstanding debt of its clients. For fiscal year 2006 the new bond issues exceeded the principal retirement of debt by \$19 million. The operating revenues reflect this additional increase in principal debt outstanding.

The methodology for the allocation of expenses is determined by the Bureau of Bond Finance. This methodology allocates payroll and other indirect expenses on predetermined percentages. The allocation method of calculating the compensated absences liability changed this year to accurately reflect the actual payoff when it occurs. This change in the allocation method caused the Authority salary expenses to increase for 2006. Because of the change in the allocation method the Authority had an operating loss for the year.

The net assets of the Authority are invested as part of the State Treasurer's Common Cash Pool. Interest rates were more attractive for 2006 which resulted in an increase in nonoperating revenue from the prior year. The average interest rates were 3.3% and 2.5% for 2006 and 2005, respectively.

Economic conditions were favorable for the Authority this fiscal year. The Authority's clients realized attractive interest rates on their loans. The Authority issued over \$36 million in debt this past fiscal year with interest rates varying from 2.65% to 3.50%.

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY**  
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**STATEMENT OF NET ASSETS**  
**SEPTEMBER 30, 2006**

**ASSETS**

**CURRENT ASSETS:**

Amounts due from state treasurer (Note 1)	\$ 466,179
Amounts due from other governmental units (Note 5)	429
Other current assets:	
Fees receivable	<u>35,565</u>

TOTAL ASSETS	<u><u>\$ 502,173</u></u>
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**LIABILITIES AND NET ASSETS**

**NONCURRENT LIABILITIES:**

Employee compensated absences and sick leave (Note 2)	\$ 28,814
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**NET ASSETS:**

Unrestricted	<u>473,359</u>
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TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 502,173</u></u>
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**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY**  
**A COMPONENT UNIT OF THE STATE OF MICHIGAN**  
**STATEMENT OF ACTIVITIES**  
**YEAR ENDED SEPTEMBER 30, 2006**

Functions/programs	Expenses	Charges for services	Net revenue and change in net assets
Primary government:			
Business type activities:			
Higher Education Facilities Authority	\$ 149,466	\$ 139,331	\$ (10,135)
General revenues:			
Investment income			15,905
CHANGE IN NET ASSETS			5,770
NET ASSETS:			
Beginning of year			467,589
End of year			\$ 473,359



**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY**  
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**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEAR ENDED SEPTEMBER 30, 2006**

**OPERATING REVENUES:**

Authority fees	\$ 139,331
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**OPERATING EXPENSES:**

Personnel services	82,224
Purchased professional and technical services	61,198
Other expenses	6,044

Total operating expenses	149,466
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Operating loss	(10,135)
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**NONOPERATING REVENUES:**

Investment income	15,905
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**CHANGE IN NET ASSETS**

5,770

**NET ASSETS:**

Beginning of year	467,589
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End of year	\$ 473,359
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**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY**  
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**STATEMENT OF CASH FLOWS**  
**YEAR ENDED SEPTEMBER 30, 2006**

**CASH FLOWS FROM OPERATING ACTIVITIES:**

Receipts from customers	\$ 136,924
Payments to suppliers	(123,704)
	<hr/>
Net cash provided by operating activities	13,220
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**CASH FLOWS FROM INVESTING ACTIVITIES:**

Interest and investment income (non program)	15,905
Advances to state treasurer	(29,125)
	<hr/>
Net cash used by investing activities	(13,220)
	<hr/>

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

**CASH AND CASH EQUIVALENTS:**

Beginning of year	<hr/>
End of year	\$ <hr/> <hr/>

**RECONCILIATION OF OPERATING INCOME TO NET CASH  
PROVIDED (USED) BY OPERATING ACTIVITIES:**

Operating loss	\$ (10,135)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Changes in assets and liabilities:	
Fees receivable	(2,407)
Employee compensated absences and sick leave	25,762
	<hr/>
Total adjustments	23,355
	<hr/>
Net cash provided by operating activities	\$ 13,220
	<hr/> <hr/>

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY  
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NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Reporting Entity**

The Michigan Higher Education Facilities Authority (the “Authority”) was organized under Act No. 295 of the State of Michigan Public Acts of 1969 to issue tax-exempt bonds and lend the proceeds to nonpublic, nonprofit institutions of higher education within the State for capital improvements.

During 1992, oversight responsibility for the Authority was transferred from the Department of Education to the Department of Treasury, under Executive Order 1992-2.

The Authority is a component unit of the State of Michigan and is reported as such in the State of Michigan Comprehensive Annual Financial Report.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board Statement Nos. 14 and 39. These criteria include oversight responsibility, accountability for fiscal matters, scope of public services and special financing relationships.

In July 2002, an executive order was issued which combined the Authority’s administrative staff with the administrative staff of several similar authorities into a single work unit under the direction and supervision of the State Treasurer.

**B. Financial Statements**

The financial statements (i.e., statement of net assets, statement of activities, statement of revenues, expenses and changes in net assets and statement of cash flows) report all activities of the government. The Authority is considered a business type activity and has no component units.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include charges to customers who use, or directly benefit from services or privileges provided by a given function or segment.

**C. Measurement Focus, Basis of Accounting and Financial Statement Presentation**

The Authority is accounted for as a proprietary fund. A proprietary fund is used to account for operations:

- a) That are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or;

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**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**C. Measurement Focus, Basis of Accounting and Financial Statement Presentation (Concluded)**

- b) Where the governing body has decided periodic determination of revenues and expenses and net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Proprietary funds are reported using the “economic resources measurement focus” and the “accrual basis of accounting”. Revenues are recognized when earned and expenses are recognized when the materials, services, or benefits are received. Service fees and other fees and charges are recorded as income when earned, and the associated administrative expenses are recorded as incurred.

Designated trustees maintain separate accounting records pertaining to each individual bond issue for each participating facility. Assets managed by the trustees for each facility are restricted for payment of bond principal and interest and approved construction expenditures except for certain investment income which may be returned to the facility. None of the assets or liabilities held by the trustees are reflected in the Authority’s financial statements, as more fully described in Note 2.

Bond proceeds are retained by the trustees to fund interest costs and principal payments during the period of construction. After the construction period, interest and principal payments are funded by regular loan payments from the facilities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business -type activities and enterprise funds, subject to the same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Amounts reported as *program revenues* include charges to customers, services, or privileges provided. Likewise, general revenues include unrestricted investment income.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Authority are charges to customers for services. Operating expenses of the Authority include the cost of services, administrative expenses, and the depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**MICHIGAN HIGHER EDUCATION FACILITIES AUTHORITY**  
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**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Concluded)**

**D. Assets, Liabilities, and Net Assets**

**Amounts Due from State Treasurer:** All of the Authority's cash receipts and disbursements, as well as its cash balance are maintained by the Department of Treasury and reported on the statement of net assets as amounts due from the State Treasurer.

**Cash and Cash Equivalents:** Cash and cash equivalents include deposits with financial institutions and other highly liquid short-term investments with original maturities of less than 3 months used for cash management rather than investing activities. As of September 30, 2006, the Authority did not have any cash or cash equivalents.

**Fees Receivable** - Annual service fees due from various higher education institutions throughout Michigan are recorded on a monthly basis. Management provides for probable uncollectible amounts through a provision for bad debt expense when necessary and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements and no allowances are currently deemed necessary.

**Compensated Absences:** Vacation, banked leave time and sick pay are recorded as expenses at the time the benefit is earned by the employee taking into consideration maximum contractual amounts. The Authority is allocated a percentage of assigned employees of the Bureau of Bond Finance. Each employee's total compensated absences is multiplied by the current allocation percentage.

**Use of Estimates** - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

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NOTES TO FINANCIAL STATEMENTS**

**NOTE 2 - COMPENSATED ABSENCES**

**Plan Descriptions**

Employees accumulate annual leave (vacation) balances to a maximum ranging from 240 to 316 hours. They receive a 100% termination payment upon separation based upon their final rate of pay. Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employee's sick leave accumulation times their final rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave which increases from 0% to 50% depending upon the balance of their sick leave hours. From October 2003 through October 2005, employees were required to participate in the Banked Leave Time (BLT) program. Under the BLT, each employees biweekly pay was reduced by up to 4 hours of pay. The unpaid time was credited to the employees BLT account and can be used for unpaid time off or it can accumulate up to 104 hours a year. Unused accumulated BLT will be paid as an employer contribution to a 401(k) plan when the employee separates from service.

**Accounting Policy**

The Authority has accrued liabilities for compensated absences as required by the GASB. Annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions. Sick leave is valued, as explained, at 0% to 50% plus the State's share of social security and retirement contributions. Banked leave time is valued at the unused accumulated hours at year end. The pay rates in effect as of October 1, 2005 are used. As of September 30, 2006, the Authority has an annual leave compensated absences liability in the amount of \$8,475, a sick leave compensated absences liability in the amount of \$17,209 and a bank leave time compensated absence liability in the amount of \$3,130.

**NOTE 3 - EMPLOYEE BENEFITS**

The employer's share of life, health, optical, dental and long-term disability insurance premiums are charged by the State of Michigan to the Authority biweekly based on each employee's selected coverage.

**Defined Benefit Pension Plan**

The Authority's employees hired prior to April 1, 1997 are enrolled in a noncontributory defined benefit plan through the State Employees' Retirement System (the "Plan") upon meeting certain eligibility requirements. The Plan provides for retiree pension and other postretirement benefits such as, dental, vision, and major medical coverage. The cost of the pension is currently funded, while the costs of the other postretirement benefits are on a pay as you go basis. The costs of these benefits are allocated to the Authority as a percentage of payroll.

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**NOTES TO FINANCIAL STATEMENTS**

**NOTE 3 - EMPLOYEE BENEFITS (Concluded)**

The Authority's covered payroll was approximately \$22,000 and \$13,000 for the years ended September 30, 2006 and 2005, respectively. The Authority's actuarially determined contribution requirements, and the contributions actually made, was approximately \$7,600 and \$4,300 representing 35% and 33% of annual covered payroll for the years ended September 30, 2006 and 2005, respectively. Prior to 2005, the Authority paid an administrative fee and did not have employees.

The State Legislature establishes the extent to which the employer and the employees are required to make contributions and establishes the benefit provisions for the Plan. Additional detail and data regarding the Plan description, vesting, and eligibility requirements, actuarial cost methods and assumptions, funding requirements, accounting policies and ten year historical trend information is provided in the SOMCAFR and the Plan's detailed financial report issued by the Office of Retirement Systems. Those reports may be obtained by writing the Department of Management and Budget, Office of Retirement Systems, 7150 Harris Drive, P.O. Box 30171, Lansing, Michigan 48909 or by calling (517) 322-6262.

**Defined Contribution Pension Plan**

The State Employees' Defined Contribution Retirement Plan (the Plan) was established to provide benefits at retirement to employees of the State who were hired after March 31, 1997 and to those members of the State Employees' Retirement (defined benefit) System, who elect to transfer to the plan. The Plan is administered by the State Treasurer. The State is required to contribute 4% of annual covered payroll. The State is also required to match employee contributions up to 3% of annual covered payroll. Plan provisions and contribution requirements are established and may be amended by the Legislature. The Authority transferred approximately \$700 to the State for its employer contribution. Employee contributions to the Plan were not significant.

**Deferred Compensation Plan**

Employees may also participate in a Section 457 plan and a 401(k) plan. Neither the Authority or the State makes an employer contribution to these plans. The assets and liabilities of the Section 457 and 401(k) plans are reported in the SOMCAFR and are not reported in the Authority's balance sheet.

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**NOTES TO FINANCIAL STATEMENTS**

**NOTE 4 - UNRECORDED LIMITED OBLIGATION DEBT**

The Authority has certain bonds outstanding. The trustee, fiscal agent, registrar, and paying agent functions for the defeased bonds are performed by an Authority designated trustee. Because these obligations are, in substance, debts of other entities, the liabilities and related assets are not reflected in the Authority's financial statements. All bonds are limited obligations of the Authority and do not constitute a general obligation of the State of Michigan or the Authority.

For bond issues, which have been defeased in-substance, the proceeds of new bonds have been placed in irrevocable trust to provide for all future debt service payments on the old bonds. Economic gains and accounting gains and losses upon in-substance defeasance inure to the benefit of the facility for which the bonds were issued and accordingly are not reflected in the Authority's financial statements.

The defeased, defeased and total outstanding bonds as of September 30, 2006 follows:

Defeased	\$ 8,730,000
Defeased	<u>410,875,000</u>
	<u><u>\$ 419,605,000</u></u>

**NOTE 5 - TRANSACTIONS WITH OTHER STATE AGENCIES**

The Authority is charged by other state agencies and departments for certain accounting, auditing and legal services. These fees were approximately \$56,700 for the year ended September 30, 2006. No amounts were due the other state agencies and departments for these charges as of September 30, 2006.

The Authority received reimbursements from other state agencies for expenses relating to salaries and administrative costs in the amount of \$1,268. As of September 30, 2006, \$429 was due to the Authority.





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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Michigan Higher Education Facilities Authority  
Lansing, Michigan

October 17, 2006

We have audited the basic financial statements of the Michigan Higher Education Facilities Authority, a proprietary component unit of the State of Michigan, as of and for the year ended September 30, 2006, and have issued our report thereon dated October 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Michigan Higher Education Facilities Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan Higher Education Facilities Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Authority and management and is not intended to be and should not be used by anyone other than these specified parties.

*Maner, Costinison & Ellis, P.C.*

Certified Public Accountants